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Ms. R. M. Burton, Director
Mineral Management Service
Attention: Policy and Management Improvement
1849 C Street NW
Mail Stop 4230
Washington, DC 202240-0001

June 11, 2004

RE: Comments on the Interests of the MMS in the Open and Non-discriminatory Movement of Oil and Gas as Required by the Outer Continental Shelf Lands Act

Dear Ms. Burton:

Shell Pipeline Company LP ("SPLC") as an Owner and Operator of various pipeline systems in the Gulf of Mexico ("GOM") respectfully responds to the Minerals Management Service ("MMS") request for comments on the interests of the MMS in the open and non-discriminatory movement of oil and gas as required by the Outer Continental Shelf Lands Act ("OSCLA"). SPLC's comments are limited to crude oil petroleum as open access and non-discriminatory movement applies and should not be construed to reach any issues associated with natural gas or the exploration, production or processing facilities for oil and gas.

SPLC agrees with other commentators that the MMS should address fundamental principles in any rulemaking to implement its authority pursuant to the open and non-discriminatory provisions in sections 5(e) and (f) of OCSLA. First, the MMS should not establish a regulatory regime that goes beyond the scope of the authority granted to MMS under OCSLA. Second, in any rulemaking the MMS should consult with other agencies that have experience and carefully tailored tasks under OSCLA such as the Federal Energy Regulatory Commission ("FERC"). Finally, any regulatory regime adopted in this rulemaking should not impose excessive burdens, but rather should carefully balance the need for the regulations with their associated burdens.

In determining the scope of its authority under OCLSA, the MMS should consider applicable statutes and FERC precedents, including those that may now be vacated. For example, the MMS should consider that OCSLA is intended to apply to pipeline facilities and similarly that certain pipeline facilities should be exempt from any regulations. More specifically, the MMS should allow for the exemptions of other agencies for crude oil pipelines that obtain contract carrier status, pipelines subject to FERC jurisdiction; Shipper–Owned or Single Shipper Systems; and pipelines subject to the Interstate Commerce Act.

SPLC appreciates the opportunity to provide comments and believes that the MMS is using a methodical and systematic approach to understanding issues that the parties face in implementing its authority to regulate pipelines subject to OCSLA. Throughout the meetings held by the MMS in its initial steps to develop an understanding of the issues, the MMS asked several producers "how pervasive is the problem?" In response, Mr. Costan and others argued that it was impossible to know the scope of the problem without regulations that require reporting.

In contrast, SPLC believes that reporting is not necessary and that the problem is not pervasive and limited to a few litigated matters. Therefore, Customers of oil pipelines should have the burden of producing specific and concrete examples where open and non-discriminatory access has been denied rather than merely make allegations to have the MMS implement regulations that require onerous reporting. Additionally, Companies currently have an avenue to complain about discrimination or other harms and that avenue is litigation. However, only a few cases have been litigated considering the number of barrels of oil that is produced on the Outer Continental Shelf ("OCS") and transported by pipeline to shore daily. This would lead one to conclude that the problem is not pervasive because the more egregious examples appear to have been litigated and the lesser ones have been satisfactorily resolved by the Shippers and Carriers. Until recently, the industry believed that the FERC had jurisdiction over these issues. Therefore, industry behaviors have been guided and governed by the light-handed regulatory oversight provided by the FERC. Consequently, the lack of concrete examples of discrimination during the meetings, minimal litigation, and the successful light-handed regulation by the FERC demonstrates that regulation and related reporting is not required.

To the extent that the MMS adopts a regulatory regime to enforce its authority under OCSLA, it should not impose onerous reporting burdens. SPLC believes that reporting is not necessary and recommends that the MMS should not adopt a program such as the reporting requirements implemented by FERC in its Order No. 639 until the pervasiveness of the problem is understood with further commenting available to industry, considering the proper exemptions and other issues.

Finally, SPLC raises issues to highlight the importance of crude oil quality. Care should be taken regarding complex issues associated with crude quality among producers and refiners as pipeline companies merely provide transportation services. More specifically, before the MMS considers regulations which would require extensive modifications to pipelines and other facilities to accommodate batching of crude oil or private contract issues associated with quality banks, a technical conference should be held to understand the risks and costs prior to implementing regulations to solve problems that may not exist.

Again, SPLC appreciates the opportunity to provide comments. If you have additional questions or require additional information, please contact me at 713-241-3676.

Very truly yours,

/s/ Joan Weessies

Joan Weessies
Director, Economic Regulation and Tariff Services

UNITED STATES OF AMERICA
DEPARTMENT OF INTERIOR

MINERALS MANAGEMENT SERVICE

The Open and Non-Discriminatory Movement of Oil and Gas as Required by the Outer Continental Shelf Lands Act	**)**	**Advance Notice of Proposed Rulemaking**
30 CFR Part 200	**)**	

COMMENTS OF SHELL PIPELINE COMPANY LP

I. BASIS FOR COMMENTS

Shell Pipeline Company LP ("SPLC") as a Pipeline Owner and Operator respectfully responds to the MMS request for comments as outlined in the April 12, 2004 Advance Notice of Proposed Rulemaking ("Notice") issued by the Minerals Management Service ("MMS"). *See The Open and Non-Discriminatory Movement of Oil and Gas as Required by the Outer Continental Shelf Lands Act*, 69 Fed. Reg. 19,137 (April 12, 2004). SPLC's comments are limited to crude oil petroleum as open access and non-discriminatory movement applies thereto and should not be construed or interpreted to reach any issues associated with natural gas or the exploration, production, or processing facilities for oil and gas.

In the Notice, the MMS expresses interest in comments of interested parties in proposed rulemaking for the open and non-discriminatory access to facilities amending its regulations to implement Sections 5(e) and (f) of the Outer Continental Shelf Lands Act ("OCSLA"). SPLC provides comments to aid the MMS in determining whether rules should be developed; and, if so, the scope of any new rules. SPLC respectfully organizes its comments and addresses issues outlined in the Notice and OCSLA Workshops held pursuant to the Notice; and where possible

refers to the specific provision, section or paragraph of statutory law, case law or existing regulations or factual information which the MMS wishes to be addressed.

SPLC is commenting because it has extensive experience and a substantial interest in this topic as it has many right-of-way grants for pipelines regulated by the MMS and is one of the largest service providers transporting crude oil in the Gulf of Mexico ("GOM"). Thus, as a Pipeline Owner and Operator, SPLC has substantial experience and a significant interest in the proposed rulemaking.

Finally, in one other general matter, it is important for the MMS to understand the context in which SPLC defines its Customers. Customers of an oil pipeline company are: 1) the Producers; 2) the Shippers; and 3) the Refiners. The Producer is the customer owning the platform and facilities from which the oil pipeline transports crude oil. The Shipper in the oil pipeline system is the entity who has title to the oil that is being transported and is the entity paying the transportation rate to the oil pipeline company. The Shipper is often not the Producer; instead the Shipper is often a company that has entered into a contractual agreement to purchase crude oil at the platform from the Producer for trading at a market center or crude supply for a refinery. The Refiner is the end user of the crude transported through and individual pipeline or multiple pipelines. Hence, the nature of the relationships involved in oil transportation is complex and this complexity is only exasperated because each party has different interests that related to the open and non-discriminatory access to pipelines. Consequently, applying legal standards associated with open and non-discriminatory principles among Customers does not yield any clear and concise analysis because these parties have varying interests.

II. DISCUSSION

A. The Meaning of Open and Non-discriminatory Access

As an introductory matter, realizing that FERC may not have had authority under OCSLA, the industry believed that FERC had authority and believes that the light-handed regulation employed by FERC was and would continue to be appropriate. Therefore, SPLC urges the MMS to continue to apply the FERC methodology and apply the precedents that have been developed. While the FERC may not have had jurisdiction and only certain duties under OCSLA, it established valuable precedents and did realize the complex and abstract nature of making determinations of whether Shippers had been denied open and non-discriminatory access to pipelines.

The history of OSCLA and FERC's exercise of jurisdiction prior to the D.C. Circuits decision in *The Williams Cos. v. FERC*, 345 F.3d 910 (D.C. Cir. 2003) has shown the standards for addressing the abstract concepts of open and non-discriminatory access may not lend themselves to any quantitative and clear analysis. Applying these legal standards to Customers with varying positions and interests makes the task more complex. Hence, bright line tests, new regulations, or new standards will not aid in easier determinations. Instead, well-established precedents should be applied and continually developed on a case-by-case basis considering the unique facts and circumstances presented in actual cases and controversies. This case-by-case approach, despite FERC's lack of jurisdiction in some circumstances, was reasonable and provides a road map for the MMS.

B. The Producers Coalition Proposed Reporting Requirements are not Warranted by any Findings.

The Producers Coalition proposed regulations requiring quarterly reporting related to the price and other material economic terms of contracts and full transparency for compliance

filings. However, throughout the meetings held by the MMS in its initial steps to develop an understanding of the issues, the MMS asked Producers how pervasive is the problem? In response, Mr. Costan and other producers argued that it was impossible to know the scope of the problem without reporting. *See* Houston OCSLA Workshop 3-8.

In contrast, SPLC believes that reporting is not necessary and that the problem is not pervasive because Companies currently have an avenue to complain about discrimination or other harms and that avenue is litigation. However, only a few cases have been litigated considering the number of barrels of oil that is produced on the Outer Continental Shelf ("OCS") and transported by pipeline to shore daily. This would lead one to conclude that the problem is not pervasive because the more egregious examples appear to have been litigated and the lesser ones have been satisfactorily resolved by the Shippers and Carriers. Until recently, the industry believed that the FERC had jurisdiction over these issues. Therefore, industry behaviors have been guided and governed by the light-handed regulatory oversight provided by the FERC. Consequently, the lack of concrete examples of discrimination during the Workshops, minimal litigation, and the successful light-handed regulation by the FERC demonstrates that additional regulation and related reporting is not required.

SPLC believes that reporting is not necessary and recommends that the MMS should not adopt a program such as the reporting requirements implemented by FERC in its Order No. 639 until the pervasiveness of the problem is better understood with further commenting available to the industry. To implement such a program at this point would impose an uwarranted, onerous, costly, and cumbersome reporting system on pipelines.

The MMS should first understand issues facing the parties involved, giving consideration establishing an informal process for complaints to understand the nature and scope of the

pervasiveness of the problems alleged by the Producer Coalition and others. In the event that the MMS concludes that new regulations related to reporting are warranted on completing a fact-finding investigation, it should follow the light-handed FERC approach and give due consideration to the exemptions established by precedent, regulation, and statute.

a. Pipelines subject to the Interstate Commerce Act ("ICA")

Oil pipelines subject to the ICA should be exempt from any MMS regulations under its OCSLA authority. Interstate common carrier crude oil pipelines are subject to regulation by the FERC under the ICA. The ICA ensures that similarly situated Shippers are treated equally. Additionally through this authority, the FERC regulates pipeline rates, requires adequate reporting, and provides methods for complaints and protests to determine whether discrimination has occurred. Consequently, the FERC has jurisdiction over pipelines subject to the ICA. Thus, the MMS, in the event that it concludes that regulations are necessary should allow an exemption for pipelines subject to FERC jurisdiction under the ICA.

b. Pipelines with Contract Carrier Status

In addition to an ICA exemption, pipelines with contract carrier status should also be allowed exemptions to any MMS rules to allow the orderly development of the OCS. In *Caesar Oil Pipeline Co., LLC*, 102 F.E.R.C. (CCH) ¶ 61,339 at PP 34-38 (2003) and *Proteus Oil Pipeline Co.*, 102 F.E.R.C. (CCH) ¶ 61,333 at PP 32-36 (2003), the FERC concluded that crude oil pipelines in the OCS may give priority to Shippers entering into firm contracts; i.e. contract carriers, for oil pipelines in the OCS. The FERC found that respect for firm contracts was important to support reliance interests necessary for the orderly development of the OCS, concluding that upholding pre-existing contract rights was a reasonable basis to deny access to a

Shipper. Thus, any regulation by the MMS should recognize the value of orderly developing the OCS by allowing an exemption for pipelines with contract carrier status.

c. Other Areas Where the MMS should Allow or Recommend Exemptions

While SPLC does not elaborate and discuss these exemptions, it realizes the limitations on the authority granted under OCSLA to FERC and the MMS; the MMS should affirmatively recommend to FERC that it exercise its authority to exempt feeder lines. Additionally, the MMS should exempt gas pipelines subject to the Natural Gas Act.

C. Open and Non-discriminatory Access

According to the Producer Coalition, open access entails two prongs: 1) physical access and 2) reasonable economic access. *See* Houston OSCLA Workshop at 4. SPLC is not aware of any situation where physical access has been denied on that basis alone. Nor do the producers at the workshops complain of a lack of physical access with specific examples.

1. Discrimination based on Crude Oil Quality

Complex and important issues arise with respect to crude oil quality and Customers varying interests. Before the MMS considers regulations that would require extensive modifications to pipelines and other facilities to accommodate batching of crude oil or private contract issues associated with quality banks, a technical conference should be held to understand the risks and costs prior to implementing regulations to solve problems that may not exist. Special attention should be directed to complex issues associated with crude quality among Producers and Refiners. Pipeline companies merely provide transportation services for Shippers buying crude oil from Producers, which is ultimately refined.

According to the Vision Resources, Inc. and Walter Oil and Gas (collectively "Vision"), open and non-discriminatory access has been denied on many occasions. For example, Jody Cartwright states in response to the panels question on this issue that

> [d]iscrimination occurs when pipelines refuse to ship production because the oil quality does not meet the standards set by the pipeline for other shippers presently using the facility. For pipelines that do not use quality banks, the access to that pipeline for shippers of crude oil that is a different quality from that which is being shipped is usually dependent on whether it is beneficial for the pipeline to do so. *See* Houston OSCLA Workshop at 5.

In addition to proposing quality banks as a means to eliminate discrimination on the basis of crude quality, she adds that another means of resolving this discriminatory issue is "batch[ing] similar quality crudes, but this requires large volumes." *See* Houston OSCLA Workshop at 5. Vision also states that "[n]ot all pipelines are required to institute a quality bank" *See* Houston OSCLA Workshop at 4. In response, SPLC first discusses crude oil quality in general and then addresses quality banks and batching alternatives.

Crude oil quality is the largest factor in assessing the compatibility of production with the existing production in a pipeline system and its use by sensitive, end-user refineries. Crude oil production from a new development project may be blended with existing production in a trunkline pipeline where crude oils are quality and chemically compatible. However, discrimination based on crude oil compatibility is further complicated by legal standards. The FERC has explained that discrimination may occur when there is an unjustified difference in rates or service among similarly situated customers. Thus, under this standard, prior to determining that discrimination has occurred, a Customer claiming discrimination must demonstrate that he is similarly situated. This question of whether different parties are similarly situated must be resolved on the facts presented on a case-by-case basis and does not lend itself to bright-line tests. Traditional definitions of sweet and sour crude are also unsatisfactory and do

not resolve the issues and parties interpretations are often different and litigation follows and the question is resolved on a case-by-case basis. Hence, this analysis does not lend itself to any quantitative analysis or clear solutions and any regulation by the MMS will not aid in quick resolution of the issues.

a. Vision's Allegations That Pipelines Refuse to Implement Quality Banks is Unfounded Because Quality Banks and Gravity Banks are Formed Through Private Commercial Agreements Between Shippers and Administrated by Independent Parties; Pipelines Have no Role in Forming or Administering Quality Banks and Regulation by the MMS Would Most Likely be Outside of Its Authority Under OCSLA.

Gravity banks and quality banks have been used by Shippers to compensate themselves fairly for differences in crude quality for many years in the United States. A long-standing example is the GRAVCAP quality bank that was created by Shippers over 30 years ago, demonstrating that pipelines historically are not involved in forming quality banks. Traditionally, a quality bank measures and tracks information that is relevant to the market value of crude oil and employs value factors to reasonably compensate to the extent possible, market value differences between the quality of each producer's oil and a resultant common stream. Shippers are then compensated or charged for differences in the crude they move into the common stream. Likewise, a quality bank while it may only compensate for gravity often includes other factors such as sulphur content. Quality banks may be referred to as a gravity bank; however, a gravity bank is actually a subset of a quality bank that only provides economic compensation to producers on the basis of gravity. Realizing this similarity in the economic purpose of a quality and gravity bank; they will be referred to collectively hereafter as "quality bank."

Several entities play a role in the establishment of a quality bank. The Shippers form quality banks based on contracts between themselves and search for a separate entity to complete

the administration. The commercial terms of such banks are negotiated by independent groups of shippers, not the pipeline owner or operator. Proposed terms and Shippers perspectives on values associated with crude quality may differ so substantially that the Shippers are unable to come to acceptable commercial terms. Consequently, a quality bank may never be formed. When quality bank is formed, an administrator, who is often a separate legal entity, is selected that is responsible for transactions between Shippers. Pipeline companies do not have a role in forming or setting rules associated with a quality bank, but at the Shippers request often include the quality bank and the associated costs of administration in their rules in the respective tariffs as a condition precedent to transportation. Thus, pipeline owners and operators responsibilities are wholly separate from any issue associated with the formation any quality bank. Once again, a quality bank is a Shipper instituted bank utilized by Shippers to compensate for upgrades and downgrades in common stream crude oil pipelines. The only role of the pipeline companies related to quality banks is to place the quality bank provisions in the tariff, if appropriate, as a condition of movement. Thus, pipeline companies do not have a role in forming a quality bank and may accommodate Shippers by including the quality bank in its tariff once the parameters have been agreed upon by the Shippers. Consequently, the Vision's allegations are unfounded.

Of all the commercial terms of a quality bank and the factors for which compensation is based, two principal types of quality banks exist based on the type of adjustment factor used – Fixed Adjustment Factor and Variable Adjustment Factor. Poseidon Oil Pipeline Company LLC ("Poseidon") uses a variable adjustment quality bank Poseidon explains on its web page that

> [t]he purpose of Poseidon's Market Based Quality Bank is to mitigate to the fullest extent possible, value differences between the quality of each producer's oil and the resultant Poseidon common stream. Unlike most of the quality banks in the Gulf of Mexico that use fixed adjustment factors, Poseidon uses variable adjustment factors for gravity and for sulfur that track the current market value

> difference between sweet and sour crudes. Poseidon adjusts these factors every month using the value and quality difference between Poseidon crude and a commonly traded marker crude Louisiana Light Sweet. In this way Poseidon, on a monthly basis, compensates the producer for the market value difference between crudes. *See* http://www.poseidonoil.com/QBHISTORICAL.htm.

Whether the quality bank uses a fixed or adjusting factor, the administrator calculates adjustment factors, and uses these factors to compensate or charge Shippers for the relative differences in the value of their crude oil.

Most major pipeline systems are subject to quality banks even if it does not occur directly. For example, in some cases, Shippers in downstream systems have a quality bank that uses data gathered from upstream systems to compensate all Shippers on the downstream system even when the upstream system does not have a quality bank. This lack of a quality bank in the upstream system could be the result of the case where Shippers cannot successfully negotiate the terms of a quality bank or where the oil is commingled through multiple systems. Thus, a direct connection to a pipeline could mean that a quality bank is not directly available; however, a quality bank may exist in a downstream system. Consequently, Shippers failure to successfully agree upon parameters to form a quality bank does not mean that a pipeline company has denied access or discriminated by refusing to implement a quality bank nor does it mean that a quality bank is not available in a downstream system.

In addition to the complex nature of quality banks and their formation and administration through private contracts, realizing that pipeline companies have no role in forming quality banks or managing quality banks; the MMS may not have authority under OSCLA to implement rules related to quality banks on the OCS. Before the MMS considers regulations related to private contract issues associated with quality banks, a technical conference should be held to

understand the risks and costs prior to implementing regulations to solve problems that may not exist.

Hence, the MMS should not propose new rules related to quality banks. First, Vision is mistaken as to the role of pipeline owners and operators in forming quality banks. They fail to realize that quality banks are private contractual agreements between Shippers. Thus, their allegations related to pipeline companies are unfounded. Similarly, given the misunderstanding of Vision and the complex issues associated with quality banks, the MMS should further investigate the nature and scope of the issues through a technical conference. Finally, the MMS should carefully consider its authority under OSCLA to regulate quality banks.

b. While Batching is Physically Possible; the Vision's Statements That Batching is an Alternative to Prevent Discrimination is an Understatement Because it is Economically Prohibitive and Implementing Regulations May be Outside of the Scope of the MMS Rulemaking Authority Under OCSLA.

In addition to proposing that the MMS regulate contracts among private parties that have nothing to do with discrimination by pipelines, Vision claims that batching crude may be a solution to discrimination based on crude oil quality. *See* Houston OSCLA Workshop at 4 (explaining that where crude oil does not match the quality or chemical characteristics of the common crude oil stream; the different types of crude may be batched.) Crude oil can generally be described as fungible; however, pipelines provide transportation services at the requests of Shippers, and must be sensitive to the needs of all Customers, including producers and end users such as Refiners that are sensitive to crude oil quality for varying reasons. Thus, pipeline owners and operators must be cognizant of the differences in crude oil quality and the complex issues that arise in batching crude oil on the OCS.

Batching reduces the capacity of a pipeline, and in the case of the existing offshore infrastructure requires analysis, re-design, construction, additional labor costs, and implementing

batch tracking to prevent commingling that makes it economically prohibitive. Not only would batching crude in offshore systems require the construction of fixed or floating storage tanks but also the building of new pipelines and re-routing of flow lines to these new storage tanks that makes this an uneconomical alternative. Nonetheless, reduction in capacity of OCS pipeline systems should be of primary importance.

The story regarding the reduction of capacity in a pipeline system due to batching can be best told by relating to what we know today about transportation of the nation's gasoline supply. The American Petroleum Institute gives a valid synopsis, stating that

> THE NATION'S 200,000-mile oil pipeline system is the world's largest. These almost invisible ribbons of steel deliver more than 13.3 billion barrels of crude oil and petroleum products in a typical year. That is two-thirds of the petroleum transported within the country. Without them to move crude oil and petroleum products, it would take thousands of trucks and barges clogging the nation's roads and waterways to do the same job."
>
> The capacity of the system is being seriously eroded. The cause is the increased demand for "boutique fuels"— fuels with unique specifications for different cities or regions. Pipeline companies are forced to segregate each of the products into "batches" and separate the batches so they can be distributed along a single pipeline. Each additional product makes batching more difficult and calls for even more care to maintain that fuel's integrity and quality.
>
> One pipeline company, Atlanta-based Colonial, delivers 90 different products for 85 shippers to 270 terminals and more than 1,000 storage tanks. In any given month, Colonial may ship 30 different grades of gasoline. Examples abound. Atlanta and Birmingham, for instance, require gasoline that is different than anywhere else in the country.
>
> It hasn't always been this way. In the 1970s, there were just six different types of gasoline, two types of jet and kerosene and three types of diesel. This simpler mix of products is what pipelines were designed to handle. But as state and local governments impose the different standards on gasoline and other fuels to meet air and water statutes, it significantly increases the product types. This takes away flexibility and ultimately reduces a pipeline's effective capacity. The trend began in the 1980s with the phase-in of unleaded gasoline. It accelerated in the 1990s when the industry began providing significantly more grades of gasoline to meet changing environmental regulations. Reformulated gasoline was introduced in several regions that did not attain clean-air requirements.
>
> To make better use of America's pipeline system, the nation should standardize grades to reduce the number of local grades. Also, regulations should permit the commingling of products in the distribution segment during phase-in

> periods. This would allow a pipeline to ship a common product from different refiners that may be at different stages of the phase-in period. The alternative is a continued capacity squeeze and potentially higher transmission costs. *See* http://api-ec.api.org/filelibrary/pipeline22.pdf

In the long-term Vision is proposing a similar scenario with crude oil petroleum in the pipelines subject to OCSLA. Vision cannot identify situations where batching is proposed nor where producers have been denied access to a system on this basis. If this situation exists, it is undoubtedly an isolated and justified case. Nontheless, what the producers are suggesting is a crude oil boutique operation. Costs of this operation would be prohibitive and if the Pipeline companies were to attempt to pass the costs along, the Shippers would argue that they are being denied access from an economic perspective. As the scenario depicted above by the API demonstrates that batching a system makes it more complex and reduces the operating capacity of a pipeline system. Consequently, what the producers are proposing as a solution clearly affects the capacity of the pipeline systems located on the OCS that results in changes to the infrastructure, lower rated capacity of trunkline systems, and higher transportation costs.

In addition to the issues related to a reduction in capacity, generally, the current infrastructure in the GOM is completely inadequate to allow batching and any requirements to batch will impose immeasurable costs to producers for the modifications of their systems. Entire systems including both the export pipelines and producer equipment would have to be modified with a wide range of flexibility to accommodate ever-changing production profiles to allow batching of crude oil. Because a producer who has a different crude type will be required to deliver crude oil at full line rates that are orders of magnitude larger than current deliveries, laterals, pumping equipment, and measurement equipment connected to a trunkline gathering system would be inadequate to batch crude oil in the existing trunklines. The same is true for

storage tanks at onshore and offshore locations. Producers would have to build additional tanks because during the time when crude oil is being injected into the trunkline as a batch, other producers on the system depending on the relative locations of the laterals and the size of the batch must shut down their pipeline pumps and store crude oil that is being produced. Most onshore crude oil storage terminals are built to handle a single crude not a batched crude stream. Similarly, storage tanks are essentially non-existent at offshore locations. The restriction of available physical space and structural capacity of existing platforms further complicate offshore storage.

Once these physical constraints on offshore platform storage are realized, floating storage becomes the next alternative. Floating storage raises issue related to operating costs and concerns from environmental and safety perspective. SPLC also believes that most producers would not want tanks moored to or near their offshore structures from a safety and environmental perspective.

In addition to these concerns and needs to substantially modify the existing infrastructure, batching crude on the OCS becomes more complex with the suggestion that crude oil batches are separated by pigs. First, not all trunk lines are of the same diameter for their entire length on the OCS. As such, batching is physically impossible in multi-diameter trunklines. Assuming that this multi-diameter problem is eliminated or non-existent laterals that connect producers to trunklines are not the same size. Batching with pigs would require launching pigs in the trunkline at its origin to create a sufficiently sized batch to allow producers with similar crude quality to inject their oil into the batch as it passes their laterals to prevent commingling with other crude. To accomplish this injection operation successfully, pipeline operators would have to implement a batch-tracking system that would notify producers when to inject oil into the

trunkline to prevent commingling. Launching and receiving the pigs would require additional launchers and receivers at origins and destinations and additional manpower as well as a logistical organization to transport pigs from docks to offshore locations. Thus, batching with pigs is more costly than batching without pigs and is at least as economically prohibitive and requires substantial modifications to offshore systems.

Consequently, at the absolute minimum, batching crude oil in offshore systems will require substantial modifications. Pipeline operators will have to implement batch-tracking systems and provide logistical means for handling additional pigs. Producers would have to rebuild oversized laterals, modify or replace pumping and measurement equipment, and construct or add costly storage at offshore facilities and at pipeline onshore locations to accommodate production profiles of all producers connected to a trunkline system. The cost to modify equipment in these complex systems does not consider the costs of analysis and re-design of the overall infrastructure to accommodate batching.

This analysis would be complex, costly, and must necessarily be carried out by the trunkline owner or operator at an added cost not currently present. Among other things, the evaluation of batching scenarios will be dependent on information from each and every producer related to crude oil types, quantity and quality, production rates, and production profiles. Each of these scenarios would have to be carefully evaluated on a case-by-case basis. This analysis will require detailed information and the assistance of producer personnel. In the event that batching is required, producers should pay the costs of analysis, design, and construction of the new system as well as the incremental operating costs. Thus, any producer understanding the associated issues with batching in offshore systems would easily conclude that while it could be

physically possible to batch crude in some offshore systems; it is economically impossible and would never be the preferred choice of a producer seeking the highest net back.

In addition to the complex nature of batching crude and crude quality issues faced by all parties, the FERC has concluded it is a threshold issue to determine whether Producers with varying crude qualities may be similarly situated for purposes open and non-discriminatory access. In addition these types of threshold issues, the MMS may not have authority under OSCLA to implement rules related to batching crude on the OCS.

Consequently, the MMS should not propose new rules related to batching crude. First, producers are mistaken as to the complexity and costs of batching in offshore pipelines as evidenced by Vision's statement that "batch[ing] similar quality crudes [is an alternative means of resolving the issues associated with discrimination on the basis of oil quality], but this requires large volumes." *See* Houston OSCLA Workshop at 5. Similarly, before the MMS considers regulations which would require extensive modifications to pipelines and other facilities to accommodate batching of crude oil, a technical conference should be held to understand the risks and costs prior to implementing regulations to solve problems that may not exist.

B. Discrimination Based on Rates and Tariffs

Rates for the transportation of crude vary for a number of reasons. Pipeline companies, in manner analogous to that of producers, consider a number of factors for the economic development of oil reserves, pipeline companies consider similar factors in rate proposals. Some of the primary considerations in assessing rates include, the volume of the reserves, water depth, sea floor features and other ambient conditions and their effects on lateral routing, availability of lease dedications, throughput and deficiency agreements, future reserves in the area, excess

capacity in existing connecting pipelines and costs for the use of drag reducing agents, required expansion plans, and cost to connect the reserves.

1. The Producers Allegations That Canceling FERC Tariffs Has Resulted In Discrimination Rate Increases and A Lack Of Transparency Is Unfounded And Limited At Best

In the Workshops, the Producers Coalition also explained that many pipeline companies have canceled their FERC tariffs and alleged that these cancellations allows companies to raise rates without any regulatory oversight. SPLC believes that many FERC tariffs have been appropriately canceled. However, SPLC does not believe that pipeline companies have raised rates excessively subsequent to the cancellation of FERC tariffs. SPLC has continued to use the FERC index for its rate increases and even if rates had increased substantially; the Shippers would have had the opportunity to discuss this with the oil pipeline. SPLC and several others voluntarily choose to continue to publish these rate sheets and where rates are not published Producers need to merely contact the correct pipeline company and request rates or proposals. All rates published by SPLC for itself and operated entities can be found on the SPLC website. *See* www.shellpipeline.com. In the event that the MMS finds this problem pervasive it may implement an Enforcement Hotline to allow Customers that are not satisfied with rates or other issues to complain.

2. Factors That May Lead to a Rate Increase in Older Pipeline Systems

In assessing rate increases, the age and condition of the existing infrastructure will be evaluated with respect to required repairs and declining production. If due diligence studies show that substantial repair is required, new construction may be preferred. The scope of repairs may require retrofitting of a pipeline system and increased maintenance costs to maintain the system, which are in turn translated to higher costs of operation for the pipeline owner. The

Customer may find the repairs or the increased maintenance cost unattractive and builds or connects to a different pipeline system.

Several factors could lead to a justifiable rate increase in older pipeline systems. First, regulatory oversight imposes a certain level of fixed costs where under some circumstances pipeline companies may never recover its costs in older systems. For example, MMS regulations require that meters be proved once per month and that tickets be written twice monthly. Pipeline companies increase rates to cover costs associated with these and other tasks. Producers then complain of rate increases when there may only be producing a few barrels of oil produced per day. With pipeline revenues of only a few dollars per day, a pipeline company cannot afford to pay for increasing helicopter costs and technician time to prove a meter once per month and to write tickets twice per month. However, SPLC is aware that Producers Coalition is working with the MMS to change these requirements for certain platforms. Efforts such as these are beneficial to pipeline Customers in minimizing costs. Similarly, rate increases may be warranted when production volumes are below the agreed amount or have been otherwise reduced. In other circumstances a rate increase may be justified when a pipeline company's costs have increased beyond those contemplated. Despite these justified reasons for rate increases other pipeline companies or producers may cap the pipeline companies ability to increase rates by building new lines.

IV. DISCUSSION OF ISSUES WHERE THE MMS IS REQUESTING INFORMATION

A. The Scope, Magnitude and Seriousness of Any Instances of Discrimination

With regard to "the scope, magnitude, and seriousness of any instances where access or discrimination problems were encountered" related crude oil pipelines, SPLC is aware of only a few litigated cases. *See* Notice at 19139. As explained above, making factual determinations as

to whether a producer is similarly situated with respect to crude oil quality may be a difficult issue. While litigation may be costly this is a factual determination that must be made by an agency or court of competent jurisdiction. Regulations will not likely present any solution.

B. Circumstances Where Service Providers Would Deny Access

SPLC believes that service providers would properly "deny service" only in limited circumstances. *See* Notice at 19139. First, where excess capacity is not available on the pipeline system. Excess capacity could not be available for a number of reasons. For example, some pipeline companies build new systems based on contract commitments where shippers are granted firm space for their development projects. In *Caesar Oil Pipeline Co., LLC,* 102 F.E.R.C. (CCH) ¶ 61,339 at PP 34-38 (2003); *Proteus Oil Pipeline Co.*, 102 F.E.R.C. (CCH) ¶ 61,333 at PP 32-36 (2003), the FERC concluded that oil pipelines in the OCS can give priority to shippers entering into firm contracts. Also, a pipeline could simply be full and not have any physical capacity. Second, access could also be denied where crude oil quality is incompatible. Crude oil compatibility is a complex issue and can lead to necessary determinations as to whether a potential Shipper is similarly situated. However, negotiations of the parties with respect to batching, quality bank, gravity bank and other factors could be considered prior to denying access on the basis of crude quality. Third, access could be properly denied where it could lead to violation of regulation, a breach of contract, or fulfilling a prior obligation under a contract such as those imposed when pipelines have contract carrier status. The FERC agreed in *Caesar* and *Proteus*. Finally, other reasons could include environmental or safety concerns.

C. Suggestions for Preventing Open and Non-discriminatory Access

SPLC suggests that few "actions that could have been taken or should be taken to prevent" the denial of open and non-discriminatory access. *See* Notice at 19139. First, The MMS must realize that determinations related to open and non-discriminatory access do not lend themselves to bright line rules. SPLC believes as it has outlined above that the Producers Coalition other commentators allegations are not supported by specific and concrete examples and completely unfounded in other. Allegations should not lead the MMS to unwarranted rulemaking that will encourage the fishing expeditions of Customers. As such, the MMS should carefully investigate these issues through technical conferences and, if necessary, an Enforcement Hotline.

D. Records of Access Issues

SPLC does not have or maintain "[a] record of access issues that arise between shippers and service providers [that] would help the MMS to gain a better perspective on the need for a regulatory framework to ensure open and non-discriminatory pipeline access." *See* Notice at 19139.

E. Types of Complaints that the MMS Might Receive Through an Enforcement Hotline

SPLC first believes that should the MMS conclude that the current light-handed regulatory scenario is inadequate that the Hotline is a prudent first step in assessing the pervasiveness of the problem. Nonetheless, it is SPLC's experience that the FERC Hotline system works reasonably well, and the MMS may use it to gain an understanding of the pervasiveness of the problem. In this case, SPLC believes that implementation of the Hotline would be much preferred to implementing regulations without understanding the pervasiveness of the problem. However, SPLC believes that the Producers have not shown to any extent the

need for regulation over the current regulatory framework. Hence, the need for a rigorous and regular reporting is unfounded and any system contemplated by the MMS should begin with a complaint based Enforcement Hotline.

SPLC's experience in FERC Hotline, protests, and associated litigation is useful in understanding the benefits of an informal process. Thus, the MMS should consider the Hotline as a fundamental first step in assessing the pervasiveness of the problem by categorizing and tracking complaints to develop a road map to for creating regulations in the proper areas. During its lifetime the FERC Hotline has demonstrated success because it allows for resolution of complaints and provides needed information to the agency. FERC'S Hotline keeps it continually appraised of current issues and guide it to areas for possible evaluation for new regulation or changes to existing regulations. FERC's hotline is a systematic tool in making preliminary assessments as to the merits of complaints and is a useful tool to remove non-meritorious complaints from the agency as quickly as possible. Finally, FERC's Hotline is a success. While accomplishing many other benefits, FERC's hotline allows speedy and low cost resolution for a substantial majority of the complaints.

SPLC believes that the MMS can expect complaints "if it did establish a hotline" based on comments at the Workshops related to: 1) crude quality related access issues; 2) rate related access issues; and 3) possible operations related issues. *See* Notice at 19139. Without discussing complaints associated with the implementation or operation of the Hotline, SPLC believes, based on its experience with the FERC Hotline, that the MMS can clearly expect complaints from pipeline Customers.

F. Advantages and Disadvantages of Resolving Complaints Through Informal Negotiation or More Rigorous Processes

SPLC welcomes new throughputs to the systems that it owns and operates. Likewise, SPLC values repeat business in the environment in which it operates and carefully negotiates the commercial terms associated with any new connection or throughputs. SPLC proposes that the MMS carefully implement the Hotline as a first step in making assessments as to the need for regulation. While Mr. Costan is opposed to any informal process, stating that "[t]he MMS should not support an informal complaint process because it allows for delays and the ability for entities to game the system;" he apparently agrees with SPLC on the Hotline. SPLC agrees with Mr. Costan stating that "[t]he establishment of a 'hotline' is a helpful compliment to the complaint process" particularly with respect to determining where regulation is needed. *See* Houston OCSLA Workshop at 2.

SPLC believes that there are "advantages and disadvantages of resolving the complaints through an informal negotiation or a more rigorous dispute resolution process" *See* Notice at 19139. SPLC's experience is that the benefits of an informal process far outweigh any costs in the form of delays. An informal process would present the lowest cost and fastest resolution of the matter without the need for discovery. A hotline, if required, would allow for the simple resolution of a number of alleged practices that are perceived by Customers to be inconsistent with the open and non-discriminatory aspects of OCSLA.

The advantages of an informal process are numerous and include: speedy resolution; lower cost when compared to formal processes; additional negotiations; more appreciation of the issues by the agency, and better working relationships among all parties.

Disadvantages of an informal process may be numerous also; however, SPLC believes that the major disadvantages are that parties will use the process when complaints are not

justified because of it low costs of access and that parties will not properly use information disclosed in the process.

SPLC believes that a serious disadvantage could be the misuse of data gathered in an informal process. More specifically, SPLC believes that data gathering and data publication to the general public or Customers should not be objectives of any informal process. SPLC would like to ensure that information collected during an informal process is subject to confidentiality standards. Disclosure of business confidential information will affect the kinds and type of business opportunities that SPLC may offer Customers. Other Customers could use the information disclosed in earlier matters to demand the same rates regardless of whether they were similarly situated. Thus, data gathering and disclosure should not be objectives of the informal process.

As demonstrated by the above examples, an informal process is beneficial to all parties. The process should begin with a complaint on the MMS Hotline which will enable the MMS to track and maintain records of complains to determine the pervasiveness of the problem.